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IN THE

Supreme Court of the United States

October Term, 1969

No. 380

WILLIAM F. SANFORD,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled matter on the 24th day of June, 1969.

I. Opinion Below

The United States Court of Appeals for the Second Circuit affirmed the decision of the Tax Court of the United States (A1a).

The Findings of Fact and Opinion of the Tax Court of the United States is reported at 50 T.C. 81 (A4a).

II. Statement of Jurisdiction

The judgment of the Court of Appeals was made and entered on June 24, 1969.

There was no order respecting a rehearing nor granting extension of time within which to petition for certiorari.

The jurisdiction of this Court is conferred by Sec. 7482(a) of the Internal Revenue Code of 1954, and 28 U.S.C. Sec. 1254(1).

The jurisdiction of the Court of Appeals is found in the Internal Revenue Code of 1954 Sec. 7482(a) and 28 U.S.C. Sec. 1254(1).

The jurisdiction of the Tax Court of the United States is found in the Internal Revenue Code of 1954, Sec. 7442.

III. Question Presented for Review

Is Treasury Regulation § 1.274-5(c)(2)(iii) valid when it directly contradicts § 274 of the Internal Revenue Code, 26 U.S.C. § 274 by requiring documentary proof of entertaining expenses in excess of $25 in addition to the "adequate record" required by said section of the Law?

IV. Statutes Involved

The Constitution of the United States Article II Section 3:

> "he shall take Care that the Laws be faithfully executed * * *."

Another Department may be empowered to

> "fill up the details" of a statute. *Wayman* v. *Southard* 10 Wheat. 1 (1825).

INTERNAL REVENUE CODE OF 1954

Sec. 274(d):

"*Substantiation Required.*—No deduction shall be allowed— * * *

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, * * *

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations."

INCOME TAX REGULATIONS

Sec. 1.274-5(c)(2)(iii):

"*Documentary evidence.* Documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure shall be required for— * * *

(b) Any other expenditure of $25 or more, except, for transportation charges, documentary evidence will not be required if not readily available,

provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such require-

ments in circumstances where he determines it is impracticable for such documentary evidence to be required.. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, and, if a charge is made for an item other than meals and beverages, an indication that such is the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check, together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose."

V. Statement of the Case

Petitioner was employed during the year 1963 by RKO General Broadcasting, Inc. (hereinafter referred to as RKO), as an outside salesman of television advertising time. Most of his sales were made through the presentation of recommendations to buy television advertising time, and these "presentations" were often made at luncheons or dinners, either at restaurants or at his home. He was reimbursed by RKO $3,186.18 (Third paragraph A6a) for some of these expenditures,

generally on the average of $50 to $60 per week but it was understood that, for the most part, the petitioner would have to bear all entertainment expenses above this weekly amount. Petitioner worked on a commission basis, and his rate of commission took into account that he had to incur substantial business entertaining expenses, in obtaining and keeping accounts for which he was not reimbursed (Last paragraph A5a).

Petitioner deducted on his Federal income tax return for the year 1963 nonreimbursed business entertaining expenses totaling $5,667.17

of those less than $25 amounted to 682.86

whereas the remaining $4,984.31

were in excess of $25.

The Commissioner allowed those under $25 amounting to $682.86, but disallowed those in excess of $25 in the amount of $4.984.31, because the Income Tax Regulations Sec. 1.274-5(c)(2)(iii) requires over and above an "adequate record" also additional "documentary evidence".

Petitioner felt that he does not have to ask for or keep documentary evidence*, such as restaurant receipts, because he relied on the Law, and not on the Regulation, which Regulation is unconstitutional because it directly contradicts the Law.

The Commissioner of Internal Revenue issued a notice of deficiency under Sec. 6212(a) of the Internal Revenue Code of 1954 in respect of the Federal income tax of the petitioner,

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*"In fact, petitioner testified that he could have obtained receipts for these expenditures, and indeed often did so when he sought reimbursement of a particular expenditure from his employer. * * *The only reason suggested for his failure to obtain or retain receipts for unreimbursed entertainment expenses of $25 or more was the advice of his lawyer, which appears to have been based on the lawyer's conclusion that the regulations were invalid." (Second paragraph A15a).

Consequently the basis for the Federal jurisdiction in the Tax Court of the United States is Sec. 7442 of the Internal Revenue Code of 1954.

VI. Argument

A. *Reasons relied on for the allowance of the writ.*

(i) A constitutional question is at issue.

(ii) The Court of Appeals has decided a Federal question of substance not theretofore determined by this Court.

(iii) The Court of Appeals has decided an important question of Federal Law, which has not been, but should be, settled by this Court.

(iv) There are already several cases decided in different Federal Courts and Administrative Agencies awaiting outcome of the present case and ready to be appealed and then to be petitioned for a writ of certiorari.

B. It is an undisputable fact that § 274 of the Internal Revenue Code does not contain any restriction on entertaining items in excess of $25, though Congress had in mind a limit of $25, on gifts only § 274 (b).[1] Congress did not intend to handle otherwise deductible entertaining expenses differently as to their amount. With this background, the Court of Appeals states, that the Treasury Regulations in issue are to be upheld, because not unreasonable and not inconsistent with the Statute under which they are promulgated. *Commissioner* v. *South Texas Co.*, 333 U.S. 496 (1948).

[1] The Tax Court deems it essential, that $25 is a prohibitive upper limit as to gifts, whereas the Regulations impose a restrictive requirement concerning entertaining expenses in excess of $25. (A15a). Prohibitive and restrictive is, of course, very different as to result, but not at all different as to putting a numerical ceiling with different consequences.

Petitioner respectfully requests this Court to rule whether Treasury Regulation § 1.274-5(c)(2)(iii) is consistent with the Statute when it states a rule which is not contained in and is contrary to Sec. 274(d) of the Internal Revenue Code.

Petitioner prays this Court to forget for a moment the question whether Congress delegated any authority to the Secretary of the Treasury as to this issue. It is significant that the Court of Appeals bypasses the constitutional issue when it relies exclusively on its opinion that the Secretary had delegated authority.

> "The Power of the Commissioner to prescribe regulations for the administration of the federal tax law is not the power to make law, but it is only the power to carry into effect the will of Congress as expressed by the statute. *Manhattan Company* v. *Commissioner,* 297 U.S. 129. A regulation may not alter or amend the revenue law, nor extend a statute or modify its provisions. *Campbell* v. *Galeno Chemical Co.,* 281 U.S. 599."

C. The bare fact that the Courts below needed to resort to the House and Senate Committee Reports, demonstrates strikingly the untenability of their opinions.

D. This same issue had been debated by Senator Smathers with the then Commissioner Caplin. The weakness of Mr. Caplin's defense best demonstrates its absurdity (A21a *et seq.*).

E. The Court of Appeals makes it stronger when it states that

> "the disputed Regulation is not inconsistent with the statute".

It is that stage of the argument when it becomes necessary to invoke the delegation of the authority of Congress to the Secretary.

(a) § 274(h) [2] could of course serve the purpose in case § 274(d) itself would not clearly delimit the authority of the Secretary in respect of the rules concerning the deduction of entertainment expenses, when it states

> "The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations."

"Shall not apply" means to relent i.e. not to add requirements. "The preceding sentence" reads:

> "No deduction shall be allowed— * * *
> for any item with respect to an activity which is of a type generally considered to constitute entertainment, * * *
>
> unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer or persons entertained, using the facility, or receiving the gift."

(b) By alphabetically indexing the requirements Congress obviously intended to exhaustively enumerate the data which a record has to contain.

Accordingly the petitioner respectfully prays this Court to find

I. That the general authority of the Secretary established by § 274(h) does not comprise the matters contained in § 274(d).

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[2] Which is a general authority and not as the Court of Appeals calls it: a specific authority.

II. That the Secretary is vested with a delegated authority, but only to provide relaxations "of the requirements of the preceding sentence" not exceeding an amount to be stated by the Secretary.

It was said

> "As the Act does not provide, the conclusion is inescapable that Congress did not so intend." *Hays v. Gauley Mt. Coal Co.*, 247 U.S. 189.

(c) At that point the Courts below arrived at the last resort: the interpretation of the phrase "adequate records".

It is not necessary to search or to resort to Committee Reports to find out what Congress meant by a record being adequate:

> "a clear, contemporaneously kept diary or account book containing information with respect to the date, amount, nature and business purpose of the expense may constitute an adequate record under this provision." "S. Rept. No. 1881, 87th Cong., 2nd Sess., p. 35."

quoted by the Tax Court (A16a).

(d) Moreover the Statute clearly provides that adequate records *or* sufficient evidence is needed to substantiate business entertaining expenses, that is not both together. Thereby the Statute expressly excludes documentary evidence if there is an adequate record.

(e) This is further clarified by the fact that if a taxpayer has documentary evidence, no more record is needed because that documentary evidence fulfills the alternate method of substantiating the entertainment expense by sufficient evidence, when the Statute says:

> "unless the taxpayer substantiates by adequate records *or* by sufficient evidence corroborating his own statement * * * ." (emphasis added).

This cannot be understandably interpreted to mean that he needs an adequate record *and* sufficient evidence. If sufficient evidence is enough, why is then a record required? The Regulations clearly state:

> "It is not necessary to record information in an account book, diary, statement of expense or similar record which duplicates information reflected on a receipt so long as such account book and receipt complement each other in an orderly manner." Regulation § 1.274-5(c)(2)(i).

(f) Be it respectfully called to the attention of this Court, how far such a nonexistent delegation of authority leads. The opinion of the Tax Court complains that "petitioner never revealed the specific account discussed"[3] at the entertainments. There is no requirement in the Statute and none in the Regulations, that a taxpayer has to "reveal the specific account discussed." In the same sentence the Tax Court states a new rule that petitioner should follow the same practice as "was his customary practice * * * in supporting an expenditure which he submitted to his employer for reimbursement." No such thing can be found in any legal rule. The Tax Court got carried away and forget that Congress makes the Laws in this country.

The Government's brief before the Court of Appeals requests disregarding a taxpayer's record, because

> "nor were the entries sufficiently detailed enough to establish specific entertainment details." (First paragraph on page 14).

The Regulation could *e.g.*, prescribe that a desk-calendar is inadequate or that notations in a code are not permissible —but they do not. Nevertheless the Court of Appeals finds the desk-calendar and the code objectionable.

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[3] End of page A9a.

The Congressional mandate is clear on its face. When Congress deliberately uses the word *"and"*—it means *"and"*. This Court ruled clearly on that point in the *U.S.* v. *Correll* case, 389 U.S. 299 which dealt with the Congressional mandate concerning "meals *and* lodging". This Court ruled that the word *"and"* meant *"and"*. The word "and" is conjunctive and "meals and lodging" was held in *Correll* to be a conjunctive unit.

The Statute in this present case is at least just as clear as the Statute in *Correll*. The only difference is that in the instant case the Congressional mandate is spelled out in the disjunctive *"or"* rather than the conjunctive *"and"*.

This Court very often enunciated that to change the Law is up to Congress and not to the other Governmental Departments.

(g) As to the authority delegated to the Secretary:

> "The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *U.S.* v. *Correll*, 389 U.S. 299.

However reasonable a Regulation may be or seem to be, can the regulation be effective, if it enlarges, changes, and contradicts the Statute in question?

F. The issue presented by this case is a constitutional issue and one of principle. Nevertheless the Court of Appeals objects that petitioner

(i) used his desk-calendar as "adequate record".

(ii) the calendar notations were extremely scanty and

(iii) the notations were made in a code decipherable only by the taxpayer.

As to (i): A desk-calendar *is* a record.

Moreover: the Tax Court found as a fact that

> "The entries on this calendar identified the names of the persons entertained, the amount allegedly spent, and, by abbreviation or code, the restaurant, the advertising agency, and the alleged reason for the entertainment." (First paragraph A7a).

This is all the Statute requires; that a record be an adequate one, § 274(d).

As to (ii): The scantiness of the calendar cannot be alleged, because the Court of Appeals clearly states that

> "The Commissioner * * * allowed the alleged non-reimbursed entertainment expenses that were less than $25.00."

This is an admission that the record was not scanty, for the Commissioner would never have allowed the "less than $25" expenses if the records were not adequate.

As to (iii): The Tax Court in its opinion very clearly states:

> "the general type of business conversation which supposedly took place at each of these meals was indicated in the 'diary' by means of a 'code' (for example, the letter 'A' next to an expenditure meant that the discussion supposedly involved 'Review of advertising programs for agency's account')." (End of A9a).

This establishes the fact, that the code was and has been decipherable by anybody and especially by the Tax Court, though the Tax Court was in an extremely severe mood.

In any case the Tax Court is the fact-finding authority.

In any case, if a higher Court questions the facts found by the lower Court, it would have remanded the case for further fact-finding.

The House and Senate Reports contain the sentence

> "that no deduction is allowed solely on the basis of his own [the taxpayer's] unsupported self-serving testimony." H. Rep. No. 1447 (1962-3 Cum. Bull. 405, 427); S. Rep. No. 1881 (1962-3 Cum. Bull. 707, 741), as quoted by the Court of Appeals.

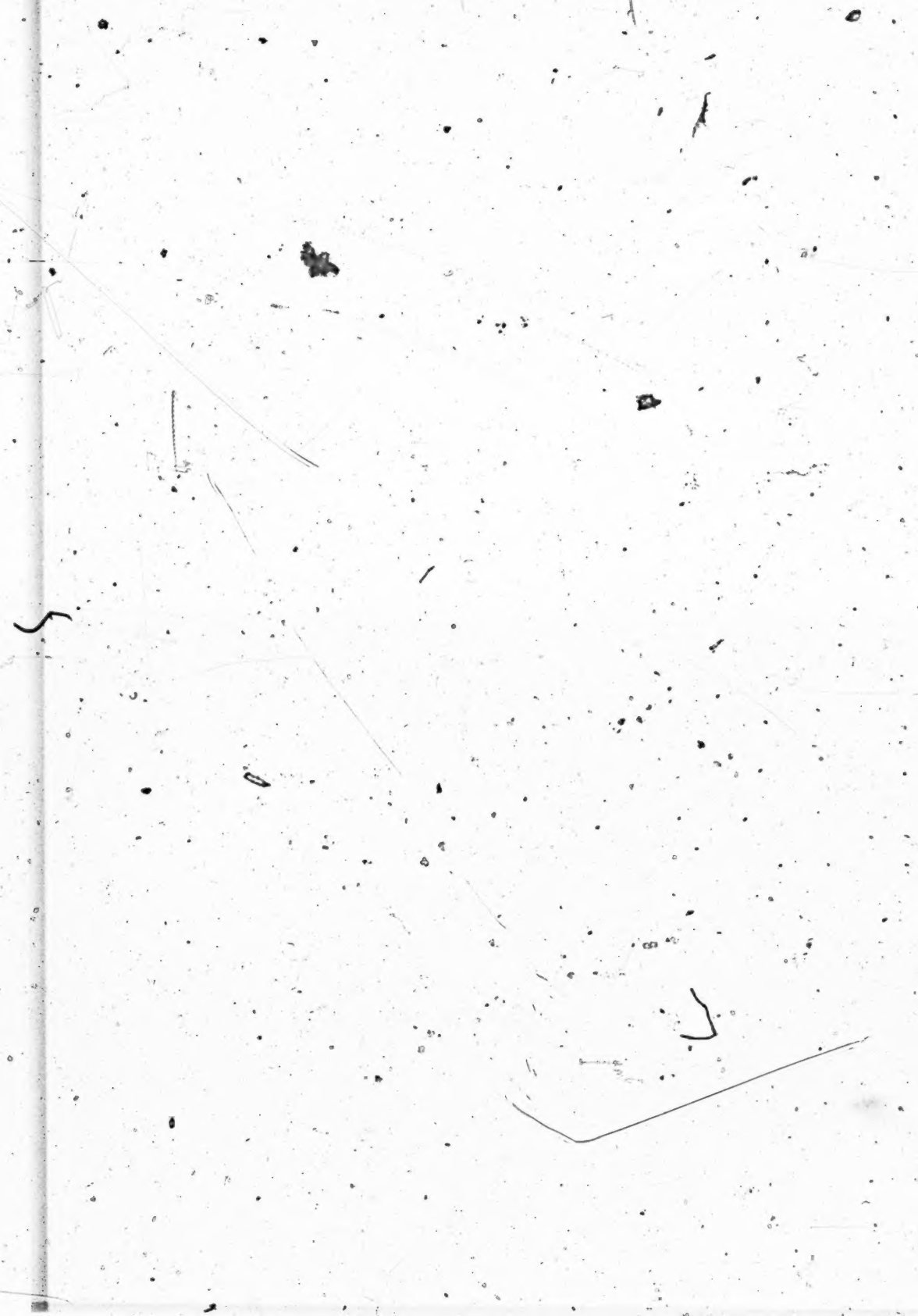
This sentence, however, is followed by the further statement that "a clear, contemporaneously kept diary or account book containing information with respect to the date, amount, nature and business purpose of the expense may constitute an adequate record under this provision."

VII. CONCLUSION

For all the foregoing reasons, a writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

GABRIEL T. PAP
Attorney for Petitioner



(APPENDIX)

Decision of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 389—September Term, 1968.

(Argued March 27, 1969 Decided June 24, 1969.)

Docket No. 32905

WILLIAM F. SANFORD,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

Before:

WATERMAN, MOORE and FRIENDLY,

Circuit Judges.

Taxpayer seeks review of decision of the United States Tax Court upholding the disallowance by the Commissioner of certain deductions taxpayer took upon his 1963 income tax return. The Tax Court is affirmed.

GABRIEL T. PAP, New York City, *for Appellant.*

ISSIE L. JENKINS, LEE A. JACKSON, ROBERT N. ANDERSON, Attys., Dept. of Justice; Johnnie M. Walters, Asst. Attorney General, Washington, D. C., *for Appellee.*

Decision of the Court of Appeals

PER CURIAM:

Taxpayer, an "outside salesman" for RKO, deducted on his federal income tax return for the year 1963 items of non-reimbursed entertainment expenses totaling $5,667.17. The Commissioner disallowed the deduction taken for any of these alleged entertainment expenditures if in excess of $25.00, and allowed the alleged non-reimbursed entertainment expenses that were less than $25.00. The latter figure amounted to $682.86. The former figure totaled $4,984.31, and the dispute here relates to the disallowance of the $4,984.31. The Comissioner disallowed these deductions taken for expenses in excess of $25.00 because, as required by Treasury Regulation 1.274-5(c)(2)(iii), the taxpayer was unable to produce any restaurant receipts or other documentary evidence to supplement notations made in code on his desk calendar.

The taxpayer petitioned the United States Tax Court for a redetermination of the tax deficiency resulting from these disallowed deductions. The Tax Court affirmed the Commissioner. Appellant now seeks a review of the decision of the Tax Court. We affirm the Tax Court.

The taxpayer's only substantial claim is that the above Regulation is invalid because it directly contradicts § 274(d) of the Internal Revenue Code, 26 U.S.C. § 274. That section begins with the statement: "No deduction shall be allowed unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement. . . ." It is the taxpayer's contention that the two methods of substantiation outlined in the Code are distinct and unambiguous, and that his desk calendar notes completely satisfied the "adequate records" method of substantiation, a method which the taxpayer argues requires no corroboration of taxpayer's own personal records.

Taxpayer's contention is without merit. Treasury regulations are to be upheld unless unreasonable and plainly

inconsistent with the statute under which they are promulgated. *Commissioner* v. *South Texas Co.*, 333 U.S. 496 (1948). Here the disputed Regulation is not inconsistent with the statute, for the phrase "adequate records" is clearly open to interpretation, and the Regulation interprets the phrase so as to carry out the stated congressional purpose of insuring "that no deduction is allowed solely on the basis of his own [the taxpayer's] unsupported self-serving testimony." H. Rep. No. 1447 (1962-3 Cum. Bull. 405, 427); S. Rep. No. 1881 (1962-3 Cum. Bull. 707, 741). Moreover, there is, of course, specific statutory authority to enact the present Regulation for § 274(h) delegates authority to the Secretary to prescribe those regulations necessary to carry out the purpose of the section.

Finally, even were we to agree with the taxpayer (which we are not) that documentary evidence was not necessary to fulfill the "adequate records" requirement, the records here would be deficient and inadequate for the calendar notations were extremely scanty and made in a code decipherable only by the taxpayer. This again is in direct contradiction of the congressional intent manifested when the provision was before the Congress. "Generally, the substantiation requirements of the bill [§ 274(d)] contemplate more detailed record keeping than is common today in business expense diaries." H. Rep. No. 1447, 87th Cong., 2d Sess. p. 23 (1962-63 Cum. Bull. 405, 427).

Affirmed.

Findings of Fact and Opinion of the Tax Court

50 T. C. No. 81

TAX COURT OF THE UNITED STATES

WILLIAM F. SANFORD,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5578-66 Filed September 9, 1968

T maintained a "diary" in which he recorded alleged business entertainment expenditures for which he received no reimbursement from his employer. He either did not obtain or retain receipts or other corroborating documentary evidence with respect to such expenditures. *Held*, the Commissioner properly disallowed deduction for all such expenditures of $25 or more. Sec. 1.274-5(c)(2), Income Tax Regs., supporting such action, is valid.

GABRIEL T. PAP, for the petitioner.

JOHN K. ANTHOLIS and POWELL W. HOLLY, JR., for the respondent.

The Commissioner determined a deficiency in petitioner's income tax for the year 1963 of $2,753.12. Petitioner disputes in this proceeding only the adjustment made by the Commissioner disallowing a deduction for certain entertainment expenses allegedly incurred by petitioner in 1963 and not reimbursed by his employer. Petitioner's

nonreimbursed expenses were recorded in a desk calendar or "diary" which purported to list certain information relating to each expenditure claimed, but he did not keep any supporting receipts or other documentary proof of the making of these expenditures. The Commissioner disallowed a deduction for petitioner's entertainment expenditures of $25 or more, but not those of less than $25. It is the correctness of this determination which constitutes the only issue in this case.

Findings of Fact

Some of the facts have been stipulated and, as stipulated, are incorporated herein by this reference along with accompanying exhibits.

William F. Sanford (hereinafter referred to as petitioner) filed his Federal income tax return for the calendar year 1963 with the district director of internal revenue, Manhattan district, New York, New York, using the cash method of accounting. This return was filed and the tax payable indicated thereon was computed on the basis that the petitioner qualified as an unmarried head of household. During the tax year and at the time the petition herein was filed petitioner resided in Chicago, Illinois.

Petitioner was employed during 1963 by RKO General Broadcasting, Inc., (hereinafter referred to as RKO), as an outside salesman of television advertising time on RKO's five television stations. Most of his sales were made through the presentation of recommendations to buy television advertising time, and these "presentations" were often made at luncheons or dinners, either at restaurants or at his home. He was reimbursed by RKO for some of these expenditures, generally on the average of $50 to $60 per week, but it was understood that, for the most part, he would have to bear all entertainment expenses above this weekly amount. Petitioner worked primarily on a commission

basis, and his rate of compensation took into account the fact that he occasionally incurred expenses in obtaining and keeping accounts for which he was not reimbursed.

On his Federal income tax return for the year 1963, petitioner listed "outside salesman expenses" totalling $13,950.35, less reimbursement from his employer, RKO, of $4,431.93, and deducted the difference of $9,518.42 as nonreimbursed employee business expenses. In his notice of deficiency, the Commissioner disallowed as a deduction $5,800.05 of the $9,518.42 claimed as business expenses, as well as $614.43 of petitioner's claimed deduction for medical expenses. In his petition to this Court, petitioner assigned as error only the disallowance of employee business expenses in the amount of $4,984.31.[1]

Among the "outside salesman expenses" listed by petitioner was an item for "Entertainment, from my record" in the amount of $8,853.35. Petitioner had been reimbursed by RKO for a portion of these expenses in the amount of $3,186.18, so that his claimed nonreimbursed entertainment expenses came to $5,667.17. The Commissioner disallowed a deduction for all alleged entertainment expenditures of $25 or more, a total of $4,984.31, which is the amount disputed by petitioner here. The remaining $682.86, representing the total of petitioner's alleged nonreimbursed entertainment expenditures of less than $25, was not disallowed by the Commissioner.

As to those entertainment expenses for which he sought and obtained reimbursement from his employer—which are not involved herein—petitioner filed a detailed expense account with his employer every Tuesday in respect of the expenses incurred during the preceding calendar week. A number of those expenses were supported by receipts or other documentary evidence. Most of these expenses repre-

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[1] Petitioner does not dispute the Commissioner's determination in respect of the disallowance of a deduction for taxi fares of $345 and for "use of home for business" of $470.74, which accounts for the remainder of the disallowed "employee business expenses."

sented the cost of lunches, and most of them ranged from about $10 to $25 each. Petitioner also maintained a desk calendar or "diary", on which he recorded those entertainment expenses for which he did not seek reimbursement. Most of the items recorded on this calendar, or diary, represented the alleged cost of dinners, and most of these involved claimed expenditures in excess of $25. The entries on this calendar identified the names of the persons entertained, the amount allegedly spent, and, by abbreviation or code, the restaurant, the advertising agency, and the alleged reason for the entertainment. However, in contrast to the expense accounts submitted to petitioner's employer, the particular client or account involved in the alleged business discussion was not identified, and in respect of none of the items recorded on the calendar did petitioner either obtain or retain any supporting receipt or other documentary evidence. No item for which petitioner sought reimbursement from his employer was recorded on the calendar.

Although the Commissioner did not disturb the deduction as to the items under $25 on the calendar, he disallowed the deduction in respect of all such items of $25 or more for want of proper substantiation, as required by section 274 of the 1954 Code and accompanying regulations. In this Court he makes the additional argument that the alleged expenses are in any event not deductible under section 162(a).

OPINION

RAUM, *Judge*: Petitioner, an outside salesman of television advertising time, claimed $8,853.35 entertainment expenses on Form 2106—"Statement of Employee Business Expenses", which was made part of his 1963 income tax return (Form 1040). This sum, according to petitioner's testimony, represented the cost of luncheons and dinners during 1963 at which petitioner discussed business with "advertising agency people". He was either ad-

vanced or reimbursed for the cost of some of those meals by his employer, and the Commissioner does not challenge the propriety of such expenses here. The remaining expenditures, those for which petitioner neither sought nor received reimbursement, were claimed by petitioner as a deduction from his gross income in the aggregate amount of $5,667.17. The Commissioner disallowed $4,984.31 of this amount, which represents the total of petitioner's alleged nonreimbursed individual expenditures of $25 or more. The Commissioner takes the position that petitioner has not only failed to demonstrate that this disallowed portion in fact represented ordinary and necessary expenses incurred in carrying on his trade or business, but also that, even if a deduction would otherwise be available to petitioner under section 162, I.R.C. 1954, such deduction must be disallowed in view of petitioner's failure to comply with the substantiation requirements of section 274(d) and accompanying regulations. More specifically, the Commissioner contends that petitioner's failure to provide receipts or other acceptable documentary proof of his expenditures of $25 or more establishes that he did not have "adequate records" of those expenditures as required by section 274(d) and accompanying regulations, while petitioner claims that a "diary" maintained by him in which the amounts of all his expenditures for entertainment were recorded, along with other information, was sufficient to meet the "adequate records" requirement, and that the regulations supporting the Commissioner's action are invalid. We hold that, while some of petitioner's claimed expenditures may have been ordinary and necessary in character, he has not complied with the substantiation requirements of section 274(d) and the regulations with respect to his expenditures for entertainment of $25 and over, that the regulations are valid, and that petitioner is not entitled to a deduction for entertainment expenses in excess of that allowed by the Commissioner.

The requirements imposed by section 274 were added to the Internal Revenue Code of 1954 by the Revenue Act of 1962, 76 Stat. 974. They are in addition to the requirements imposed by section 162, and petitioner still has the burden of proving initially that his expenditures were ordinary and necessary expenses, proximately related to his trade or business. H. Rept. No. 1447, 87th Cong., 2d Sess., p. 19 (1962); S. Rept. No. 1881, 87th Cong., 2d Sess., p. 27 (1962). Cf. *Welch* v. *Helvering*, 290 U.S. 111. We are by no means convinced that petitioner has carried this initial burden with respect to every expenditure disallowed by the Commissioner. To be sure, petitioner submitted in evidence a "diary", consisting of pages from his desk calendar bound together, which purported to show the time, place and amount of each of his nonreimbursed expenditures along with the persons entertained, the advertising agencies they represented, and the type of business discussed. But the large number of dinners claimed by petitioner as deductible expenses, approximately three per week, and the fact that the cost of petitioner's entertainment at luncheons were usually reimbursed by his employer, along with a relatively small number of dinners, suggests that at least some of his claimed nonreimbursed expenses may have been personal in nature. Certainly, the fact that petitioner may have entertained "advertising agency people" at these dinners is not conclusive of the business character of the meals, for at least some of these people may also have been personal friends of petitioner, and the business aspects of the occasion may have been minimal or wholly nonexistent. While the general type of business conversation which supposedly took place at each of these meals was indicated in the "diary" by means of a "code" (for example, the letter "A" next to an expenditure meant that the discussion supposedly involved "Review of advertising programs for agency's account"), petitioner never revealed the specific account discussed, though it was his customary practice to identify the particular account in-

volved in supporting an expenditure which he submitted to his employer for reimbursement. Similarly, though petitioner testified that he usually turned in receipts to his employer when requesting reimbursement of expenditures, he kept no receipts of his nonreimbursed expenses. Finally, petitioner's testimony that he often did not record the information relating to his nonreimbursed expenses until some days after they were incurred, and the fact that he had no doucmentary proof to support his entries, casts some doubt upon their accuracy. Taking the view most charitable to petitioner, faulty recollection may account for the fact that his "diary" records that he incurred a dinner expense of $38.18 at a Chicago[2] restaurant on November 8, 1963 when, according to the information on an expense account voucher (including a receipted hotel bill) submitted to his employer, he was in New York during the period November 7 through November 10, 1963.

Nevertheless, though petitioner's proof was deficient in some important respects and left us with the definite impression that the amount of entertainment expenses claimed by him was excessive, this might have been an appropriate case for application of the rule of *Cohan* v. *Commissioner*, 39 F. 2d 540 (C.A. 2), and we might have made an approximation of petitioner's allowable expenses were it not for section 274(d). That subsection, however, provides, in part, that "*no* deduction shall be allowed— * * *

> (2) for any item with respect to an activity which is of a type generally considered to constitute entertainment * * *
>
> * * *
>
> unless the taxpayer substantiates by *adequate records or* by *sufficient evidence* corroborating his own

[2] The restaurant was identified by code in the diary, and petitioner's testimony establishes to our satisfaction that all the restaurants set forth therein were in the Chicago area.

> statement (A) the amount of such expense * * * (B) the time and place of the * * * entertainment * * * (C) the business purpose of the expense * * *, and (D) the business relationship to the taxpayer of persons entertained * * *. The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations." (Emphasis supplied.)

Under this provision, a taxpayer must substantiate every expenditure claimed as a deduction by either "adequate records" *or* other "sufficient evidence," for such expenditures as are not thus substantiated will be disallowed *in full.*

As the House and Senate committee reports make abundantly clear, section 274(d) was "intended to overrule, with respect to * * * [entertainment] expenses, the so-called *Cohan* rule." Where, under *Cohan,* a court was not only permitted but required to make as close an approximation as it could when the evidence indicated that a taxpayer had incurred deductible expenses but their exact amount could not be determined, under section 274(d), "the entertainment, etc., expenses in such a case * * * [will] be disallowed entirely." H. Rept. No. 1447, *supra,* p. 23; S. Rept. No. 1881, *supra,* p. 35. Our opinion that petitioner has failed to substantiate his expenditures of $25 and over in the manner contemplated by the statute thus compels the conclusion that the Commissioner correctly disallowed a deduction for all such expenditures.

Terms such as "adequate" and "sufficient" obviously contemplate and require further elucidation, and the regulations promulgated under section 274(d) spell out their meaning in a carefully detailed explanation of the substantiation rules. Supported not only by the general rule making power under sections 7805 of the 1954 Code, but

also by the specific provisions of section 274(h)[3] and the last sentence of section 274(d), *supra*, the Commissioner has promulgated regulations which provide in part as follows:

* * *

Section 1.274-5(c) *Rules for substantiation*—

* * *

(2) *Substantiation by adequate records*—(i) *In general.* To meet the "adequate records" requirements of section 274(d), *a taxpayer shall maintain an account book, diary,* statement of expense or similar record (as provided in subdivision (ii) of this subparagraph) *and documentary evidence* (as provided in subdivision (iii) of this subparagraph) *which, in combination, are sufficient to establish each element of an expenditure* specified in paragraph (b)[4] of this section. * * *

* * *

(iii) *Documentary evidence. Documentary* evidence, *such as receipts, paid bills,* or *similar evidence sufficient to support an expenditure shall be required* for—

(a) Any expenditure for lodging while traveling away from home, and

(b) *Any other expenditure of $25 or more,* except, for transportation charges, documentary evidence will not be required if not readily available.

provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such requirements in circumstances where he determines it

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[3] SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(h) Regulatory Authority.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, ***.

[4] The elements specified in paragraph (b) are (i) Amount, (ii) Time, (iii) Place, (iv) Business purpose, and (v) Business relationship.

> is impracticable for such documentary evidence to be required. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, and, if a charge is made for an item other than meals and beverages, an indication that such is the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check, together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose. (Emphasis supplied.)

Thus, an "adequate" record of an expenditure is defined as an entry in an account book, diary or similar record, made "at or near the time of the expenditure," and documentary evidence such as a receipt, paid bill or similar evidence (unless the expenditure is less than $25), which in combination are sufficient to establish each of the elements of the expenditure (amount, time, place, business purpose and business relationship) for which substantiation is required by section 274(d). Moreover, in the absence of "adequate records", Regs., section 1.274-5(c)(3), provides that the taxpayer may alternatively satisfy the substantiation requirements by coming forward with "corroborative evidence sufficient" to support his own statement contain-

ing specific information in detail as to each element of the expenditure, or such elements as have not been substantiated by adequate record. And these provisions go on to state that where the unsubstantiated element is the cost, time, place or date of the expenditure "the corroborative evidence shall be direct evidence, such as a statement in writing or oral testimony of persons entertained or other witnesses * * *." Less stringent rules are provided, however, where the taxpayer is able to show that, because of the inherent nature of the situation in which the expenditure was made, he was unable to meet either the "adequate records" or the alternative "sufficient evidence" requirements, of where his failure to produce adequate records is due to the loss of such records through circumstances beyond his control. Regs. section 1.274-5(c)(4) and (5).

In the present case, it is clear that petitioner has failed to substantiate his claimed expenditures for entertainment in excess of $25 by either "adequate records" or other "sufficient evidence" as those terms are defined in the regulations. Petitioner had no receipts or other documentary evidence to support his diary entries, establishing the amount, time and place of these items, accordingly, his records cannot be considered "adequate." And he produced no direct evidence such as the testimony of the persons entertained by him, to corroborate his allegation that such expenditures were made in the amounts and at the times and places recorded in his "diary", which precludes him from relying upon the "sufficient evidence" method of substantiation. Moreover, there does not appear to be any valid reason why receipts for these claimed expenditures, incurred for luncheons and dinners at various restaurants, could not have been requested and preserved by petitioner. In fact, petitioner testified that he could have obtained receipts for these expenditures, and indeed often did so when he sought reimbursement of a particular expenditure from his employer. It would have been no more burdensome to

comply with the Commissioner's regulations than with the requirements or expectations of his employer.

The only reason suggested for his failure to obtain or retain receipts for unreimbursed entertainment expenses of $25 or more was the advice of his lawyer, which appears to have been based on the lawyer's conclusion that the regulations were invalid. That the regulations plainly support the Commissioner's position [5] is not disputed, and, in our judgment, they are clearly valid. Petitioner ignored them at his peril.

In arguing that the regulations are contrary to law, petitioner's counsel points out that section 274(b) places a $25 limit on deductible business gifts, that no such limit was prescribed by statute in connection with deductible entertainment expenses, and he contends that the Commissioner's regulations here under consideration were therefore unauthorized. The point is without merit. The regulations do not, first of all, flatly disallow a deduction for entertainment expenditures above $25 as does section 274(b) in connection with business gifts; to the contrary, they merely provide that the documentary proof ordinarily required as part of an "adequate record" of an expenditure need not be obtained in the case of expenditures below $25. Moreover, Congress deliberately refused to fix any dollar limit in connection with the substantiation requirements of section 274(d), involved herein, and expressly left the matter to be governed by regulations. After outlining

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[5] In addition to the regulations, the requirement for supporting documentary evidence was pointedly called to petitioner's attention in Form 2106 which accompanied the return signed by him, wherein it was prominently stated in large black type in a boxed paragraph captioned "IMPORTANT NOTICE" that:

> New rules on proof of deductions for travel, entertainment, and gift expenses are now in effect. * * * Estimates are not acceptable; and (3) Records must be supported by receipts, paid bills or similar substantiating evidence for expenditures of $25 or more * * *.

the substantiation requirements, Congress in the last sentence of section 274(d) explicitly provided:

> The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

This conferred ample authority to draw the line at $25.

Nor is there any compelling reason to disapprove these regulations because they require that diary entries be corroborated by documentary proof such as receipts. The history of the underlying statutory provisions, demonstrating the potential for abuse in the case of entertainment expenses,[6] makes it plain that a taxpayer must "clearly establish his right to the deduction by proof other than his own statements which may largely be self-serving." 108 Cong. Rec. 18077. See also *John L. Ashby*, 50 T.C. 409, 415. And in S. Rept. No. 1881, 87th Cong., 2d Sess., p. 35, it was stated that "Generally, the substantiation requirements of the bill contemplate more detailed record-keeping than is common today in business expense diaries." To be sure, these words were followed by the further statement that "a clear, contemporaneously kept diary or account book containing information with respect to the date, amount, nature and business purpose of the expense may constitute an adequate record under this provision."

[6] See generally Hearings Before House Committee on Ways and Means on the Tax Recommendations of the President contained in His Message Transmitted to the Congress, April 20, 1961, 87th Cong., 1st Sess., pp. 133-215 (Treasury Department's "Study on Entertainment Expenses", April 1961). One of the major abuses brought to the attention of Congress in the travel and entertainment area, the tendency of some taxpayers to overstate the true amount of their expenses, could only be satisfactorily corrected by requiring some independent verification of expenditures, such as receipts or other documentary evidence. See Hearings, *supra*, pp. 155-156.

But the import of this statement is left in doubt when one finds a substantially identical statement in the more detailed "Technical Explanation of The Bill" in the same committee report, which in turn is immediately qualified by the following language (p. 174):

> However, receipts, cancelled checks, paid bills, stubs, or other similar records may be required in certain cases, as, for example, to substantiate the amount expended for lodging and transportation while traveling on business.

Cf. H. Rept. No. 1447, 87th Cong., 2d Sess., p. A32. This suggests that "receipts, cancelled checks, paid bills, stubs, or other similar records" may be required for larger expenditures like lodging and transportation. At best, from petitioner's point of view, the committee reports are inconclusive in this respect, and we must conclude that in appropriate cases, involving larger expenditures, there was no intention to preclude the Commissioner from demanding that diary entries (self-serving statements) be supported by corroborating documentary evidence. Certainly, the Commissioner had some discretion in where to draw the line, and we cannot say that he abused his authority in fixing it at $25 for all entertainment expenses.

Moreover, nothing in the plain language of the statute is inconsistent with the regulations and we must take heed of the Supreme Court's admonition that "Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons". *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501. See also *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378; *Boske* v. *Comingore*, 177 U.S. 459, 470; *Brewster* v. *Gage*, 280 U.S. 327, 336; *Textile Mills Corp.* v. *Commissioner*, 314 U.S. 326, 336-339; *Colgate Co.* v. *United States*, 320 U.S.

422, 426. Here, the Secretary or his delegate had authority to promulgate regulations clarifying the substantiation requirements of section 274(d) and its ambiguous terms such as "adequate" records and "sufficient" evidence, not only under the general rule-making power granted in section 7805, I.R.C. 1954, but also under the mandate of section 274(h), which provides that "the Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section * * *." This gives "added reasons why interpretations of the Act and regulations under it should not be overruled by the courts unless clearly contrary to the will of Congress." *Commissioner* v. *South Texas Lumber Co., supra,* 333 U.S. 496, 503. Far from being contrary to the will of Congress, we think the regulations under consideration reflect a faithful observance of the Congressional intent.

The regulations setting forth the substantiation rules and incorporating the requirement of documentary proof were first proposed on November 8, 1962, 27 Fed. Reg. 10894 (which proposal required documentary proof of expenditures of *$10* or more), and was adopted in its present form on December 27, 1962 (T.D. 6630) Reg. Sec. 1.274-5, so that it was available to petitioner throughout the year 1963 here in issue. The Internal Revenue Service, in two published revenue procedures, allowed taxpayers a grace period until March 31, 1963, extended to July 31, 1963, in which to conform their acounting systems to the requirements of the new regulations if their accounting systems already conformed to the requirements of Rev. Rul. 60-120, 1960-1 C.B. 83, and if "good faith efforts" were made to comply with the new requirements in the interim. Rev. Proc. 63-3, 1963-1 C.B. 473; Rev. Proc. 63-18, 1963-1 C.B. 506-507. The Commissioner has not, however, relaxed his application of the documentary proof requirement in petitioner's case with respect to any of the expenditures of $25 or more incurred by petitioner during 1963, and we will not disturb his determination in this matter. An obvious reason for refusing to extend the benefits of these revenue

procedures to petitioner, assuming them to be otherwise applicable, is the lack of any showing of "good faith efforts" on petitioner's part during the first seven months of 1963, or the remaining five months for that matter, to obtain receipts, particularly in view of the fact that he did obtain receipts for his employer when applying for reimbursement.

Finally, petitioner has made some reference to section 274(e), but those provisions have no bearing on section 274(d), involved herein. In general, section 274 as a whole provides for the disallowance of certain types of deductions, whereas subsection (d) spells out the substantiation requirements that must be met where the deduction is otherwise allowable. Subsection (e) lists certain *exceptions to subsection (a)*, which deals with the disallowance of specified entertainment, amusement or recreation deductions, and one of those exceptions is found in paragraph (1) of subsection (e) dealing with "business meals." Thus, (e) (1) makes clear that subsection (a) may not be relied upon to disallow deductions for "business meals" that qualify under (e) (1). But nothing in (e) relieves the taxpayer of complying with the *substantiation* requirements of (d), which come into play only with respect to deductions otherwise allowable. The Committee reports make clear that even though an expenditure is covered by one of the exceptions to (a), the "substantiation requirements" must nevertheless "be fulfilled". H. Rept. No. 1447, 87th Cong., 2d Sess., p. A33. See also S. Rept. No. 1881, 87th Cong., 2d Sess., p. 36 ("* * * the new substantiation requirements * * * will have to be satisfied with respect to any such expense"). The same thought is set forth in Regs. section 1.274-5 (a) (2) which explicitly states that the substantiation requirements must be met in connection with any expense for entertainment, amusement, or recreation "including the items specified in section 274(e)." There is no merit to petitioner's argument based upon section 274(e).

Reviewed by the Court.

Decision will be entered for the respondent.

Extract from Hearing Before the Committee of Finance, United States Senate, Eighty-Eighth Congress, First Session

(PHOTOSTATS)

(See opposite ☛)

TRAVEL AND ENTERTAINMENT EXPENDITURES

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HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

INTERROGATION OF THE COMMISSIONER OF INTERNAL REVENUE ON PROPOSED REGULATIONS IMPLEMENTING SECTION 274 OF THE INTERNAL REVENUE CODE OF 1954 RELATING TO DEDUCTIBILITY OF BUSINESS EXPENDITURES FOR TRAVEL, ENTERTAINMENT, AND GIFTS

Held in executive session February 28, 1963; transcript released to the public April 8, 1963

Printed for the use of the Committee on Finance

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I am sure that you know, Mr. Caplin, perhaps better than most of us, the furor that was raised by the proposed substantiation regulations issued by you on November 8 of last year.

Great concern was expressed then by the business world generally. They were condemned, the regulations which you then proposed were condemned, for requiring unreasonable and unyielding meticulous recordkeeping, both by employees and by their employers.

They were condemned for requiring notes to be recorded immediately upon the incurring of an expense, rather than at the end of the business day.

They were condemned for keeping businessmen from conducting business transactions.

They were condemned for imposing such severe recordkeeping burdens that it was said that the additional expenses incurred by business in maintaining the new records would reduce revenues to the Treasury by a greater amount than would be gained through the disallowance of some entertainment expenses.

As a result of this severe criticism, you felt impelled to modify these original regulations and eased up considerably before issuing the final ones on December 27, 1962.

As a matter of fact, you even announced a number of the modifications at the December 4 hearing before witnesses were heard.

Additional changes were made after the hearing, and I am sure that there is no doubt that with each modification, there was effected an improvement over the original proposals.

It may well be that the Congress, in an effort to eliminate abuses, went too far. On the other hand, it may well be that the regulations have far exceeded congressional intent. Then, too, it may be a combination, and probably is a combination, of both. Either regulation relief, legislative relief, or a combination of both, may be warranted.

I have a personal feeling, and I, of course, could be in error, that the regulations in some instances go further than the statute actually permits.

It seems to me the taxpayers' principal objection is that they impose an excessive recordkeeping burden, which requires taxpayers to choose between forfeiting productive man-hours or forfeiting the deduction of an expense to which they are otherwise entitled.

To determine just what action, if any, may be needed. I would like to ask you some questions which I have prepared, unless you want to make a response to my general statement before I begin to ask you some questions.

STATEMENT OF MORTIMER M. CAPLIN, COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY DONALD I. LAMONT, ATTORNEY, OFFICE OF CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. CAPLIN. I would be very happy to make a preliminary response, Senator. First, I would like to express my appreciation for the very kind remarks you made at the outset, and I welcome the opportunity to meet with this committee.

As you well know, I have represented taxpayers over a period of 20 years. I have represented businessmen, large and small, over this

period, and it is my expectation, when my days end up here, to return to this endeavor.

With this background, I would just like to say that I am very sensitive to the needs of businessmen, and I regard a large part of my function as Commissioner to make sure that in the carrying out of the law we are not overzealous, and that we are not treading on the rights of taxpayers.

In promulgating these regulations, which, you know, have to be approved by the Secretary of the Treasury, we were endeavoring to be meticulous in following what we considered was the legislative intent. We studied in detail the committee reports, the language of the statute, and I would welcome wholeheartedly, Senator Smathers, any suggestion in any area where you feel that these regulations overstep the congressional intent.

This is what we are endeavoring to do in the present regulations that we have under consideration.

Now, you remarked at the outset, and it certainly was not necessary, the strong feeling that you and the other Members of Congress have against the abuses which had developed in this area. At the same time you indicated your concern about legitimate business expense deductions being allowed as deductions. This is the dual pattern we have been trying to follow.

I do not have to account to you the legislative background. As far back as 1952, Congressman King, of California, after a detailed study of tax administration, introduced a bill to disallow any business expense unless it was substantiated in accordance with the Secretary's regulations. He said at that time:

> One of the most flagrant sources of inequity and of corruption has been found in the inadequacy of existing recordkeeping records and enforcement of these requirements.

Now, this was the setting in which Internal Revenue for over 10 years endeavored to handle this problem administratively. We found evidence of black market payment, of bribery, of all sorts of unrelated expenses thrown into the travel and entertainment expense account. This was the background which the Secretary investigated after the 1960 legislation.

You will recall that the Senate passed a statute which would have abolished all expense accounts except a quiet business meal, and this went into conference. At that time the conferees asked the Secretary of the Treasury to make a report, which he did in 1961.

Now, on the specific record keeping requirements, the abolition of the Cohan rule, you will recall the committee report says that no longer is estimation to be accepted; and the statute says that there must be substantiation, substantiation by adequate records or other evidence corroborating the taxpayer's statement.

The statutes states the amount, the time, the place, the business purpose and the business relationship, must be substantiated.

The Secretary is given a discretion to eliminate some of these items up to certain amounts. This was the de minimis rule for taxis, tips, and the like.

Senator SMATHERS. Was the Secretary given the authority to go beyond that?

Mr. CAPLIN. No, he was not given the authority to go beyond that. Now, I would like to say that the regulations were not drafted in the abstract.

We called in different attorneys, accountants. We examined many forms. We conferred with business leaders. At the same time, we were very anxious to have something out by the first of the year.

We got the first draft out as soon as possible, knowing that there would be comment and hoping to get improvement. I met with over 100 tax executives in Detroit. I invited representatives from large corporations to meet in my office. The improvement that was made over the first draft was not a trading matter. It was an effort for reasonable accommodation to legitimate business needs.

Now, I recognize that there are elements in the country that have reacted strongly. But I would like to call to your attention just a couple of things, and then I would be very happy to subject myself to your questioning.

One was the National Restaurant Association on January 4, issued a public statement in which they said that:

> The Restaurant Association's complaint with the original proposals of the Internal Revenue Service would have made the burden of recordkeeping so great as to effectuate a tougher law than Congress intended.

But they close out:

> The new regulations are far more reasonable and should not create too great a problem for the honest businessman. Most of our objections were satisfied—

Said the restaurant spokesman.

Then I got a letter from the counsel of the American Hotel & Motel Association, and he says:

> We were very grateful, indeed, for the time allowed our association at the hearings held on December 4, and, although the former regulations which you published on December 27 were not all that our association would have hoped for, we do feel that, everything considered, they are very fair and reasonable, and we want you to know that we will do all in our power to encourage prompt compliance by all the member hotels in the association.

Senator SMATHERS. What is the date of that letter?

Mr. CAPLIN. That is dated January 10, 1962. Now, since then, since January——

Senator SMATHERS. 1963?

Mr. CAPLIN. Excuse me, 1963.

The letter actually has a 1962 date on it, but it was a typographical error. We received it January 29, 1963.

Since then I have conferred both with the hotel and restaurant associations, and I have arranged to come down and meet with some of the membership in Orlando to discuss these rules in greater detail.

Next, the Governor of the State of Florida wrote us a letter on January 22, in which he said:

> On behalf of the many Florida citizens who were vitally concerned as to the effect your new regulations might have on the tourism which is important to our State, I should like to express my appreciation for your fine attitude and my congratulations on the fairness which is exemplified in your rulings. I believe that you have achieved much in your drive to eliminate abuse of expense accounts without, at the same time, placing detrimental restrictions on legitimate business travel and activities.

(2) in the case of such activities directly before or after a substantial and bona fide business discussion (including business meetings at a convention of professional and business associations), if the expenses are associated with the active conduct of your trade or business.

(b) Expense of business meals furnished to an individual under circumstances which are generally considered to be conducive to a business discussion may be deductible, but so-called reciprocal meals are not. In determining whether such meals are conducive to a business discussion, you must take into account the surroundings in which furnished, your trade or business, and the relationship to your business of the person to whom the meal is furnished. There is no requirement that business actually be discussed.

As I said before, neither Congress nor Internal Revenue has any intention of curtailing legitimate business expenses. The law and the regulations are intended to allow such deductions.

The purpose of the law and the regulations is to curtail abuses in claims for deductions on travel and entertainment which were unfair to millions of taxpayers who do not have the opportunity to claim such deductions.

Legitimate business expenses for which a businessman is willing to submit receipts or keep records as specified by the law and regulations will continue to be allowed.

In the hope that this will help to reduce existing misunderstanding, I am making this letter available to the news media. If you have any other suggestions that may be of use along these lines, please do not hesitate to advise me.

With kind regards.

Sincerely,

MORTIMER M. CAPLIN, *Commissioner.*

Mr. CAPLIN. Senator, did they make available to you the reply that we had sent to them on these letters? With the chairman's permission I would like for my reply to be inserted in the record.

(The Commissioner's reply to the American Hotel & Motel Association appears on p. 25.)

Senator SMATHERS. Now, I might say we have a whole file of letters from practically every State in the Union, some from Connecticut, many from Illinois, Kentucky, Arkansas, some from Virginia, which complain about the adverse effect that these regulations are having on their business.

There are a few States that we do not have them from, but we have them from most every State in the Union, and volumes of them from some of the States, particularly my State and California, what we would ordinarily call tourist States.

I would agree with Congressman King that we want to stop abuses, I started out by saying that, but I do not believe it was ever the intention of this committee or the Congress at any time, in order to catch a few to burn down the barn.

Further, I do not believe that it was the intention of the Congress, in trying to eliminate abuses, to go so far as to frighten the business community and create an adverse effect on our general, over-all economy at a time when we are trying to stimulate that economy.

These are the things that we are concerned about, generally.

Now, specifically, on this matter of receipt requirements, your regulations require retention of receipts for travel and lodging expenses and also for other expenses of more than $25. That is correct, is it not?

Mr. CAPLIN. That is right. That is an individual expenditure. That is right.

Senator SMATHERS. Right.

What I want to ask you is: To what does the $25 limitation relate? You said individual expenditures. Does that mean anything?

Mr. CAPLIN. Let me give you an example. If you were to sit down in a bar and have some drinks with an individual who is in a natural business relationship, and the bill, not including the tip, did not amount to $25, but $24.50, or what have you, then there would be no receipt required.

Then if you later went to the restaurant down the street and had dinner together and the bill was $22, even though the aggregate expenditure was $46, you still would not need a receipt, inasmuch as they were different expenditures.

It was a question of drawing the line some place between the so-called de minimis rule, which was indicated in the statute, and the committee reports. We were trying to delineate what is de minimis.

Senator SMATHERS. Originally, you had set the amount at $10 and you later changed it?

Mr. CAPLIN. That is right. There were some people who felt that $10 was a fair de minimis provision. You could spend any amount that was fair, but, in terms of the language used in the committee reports on what was intended in the delegation of authority to the Secretary and his delegate—the example in the reports indicated something like a cabfare or a tip—we felt that at that time $10 per item was reasonable.

But, then, after discussing this with a number of businessmen, they indicated they felt $25 might be a better rule. This was the suggestion made at the hearings, $25, and we felt that was within a zone of a decent rule. We therefore went to $25 per item.

Senator SMATHERS. Let me ask you this: Do you recall anything in the statute which had any limitation of $10 or $25 or anything of that character?

Mr. CAPLIN. No. If you read the statute literally, it would begin at $1, Senator.

Senator SMATHERS. Let me just read you what I think it says. Page 35 of our committee report says:

> Generally, the substantiation requirements of the bill contemplate more detailed recordkeeping than is common today in business expense diaries. However, a clearly, contemporaneously kept diary or account book containing information with respect to the date, amount, nature, and business purpose of the expense may constitute an adequate record under this provision.

We are talking about a diary.

Mr. CAPLIN. Yes.

Senator SMATHERS. Not a receipt. What you are talking about is getting a receipt whenever it gets above $25. If the man happens to have a $25 cabfare during the day, he is supposed to get a receipt from the cabdriver?

Mr. CAPLIN. No, I believe the committee report in the next paragraph——

Senator SMATHERS. Reading the rest of it:

> Moreover, expenditures merely incidental to entertainment, travel and so forth, such as taxicab fares, tips, and similar payments, will be deductible if they are substantiated by such a diary—

it does not say anything about receipts—

> account book or similar record.

Then it goes on to say that:

The following example illustrates the operational requirements of this provision. The taxpayer establishes he traveled from California to New York on business. He should retain receipts for his transportation and his hotel expenses while in New York.

We have all agreed on that.

However, expenses incidental to that trip such as taxicab fares, tips, business lunches and so forth could be substantiated by entries in a diary.

Now, do you not agree that when you set a rule that says when you exceed $25 that you have got to have receipts from the bartender, the cab driver, or the restaurant man, that you have required something that the statute does not require?

Mr. CAPLIN. Senator, as I read this paragraph, the example of where receipts are not required are references to taxicab fares, tips and similar payments, and I would think they would normally not exceed a few dollars each.

Senator SMATHERS. Taxicab fares, tips, business lunches.

Mr. CAPLIN. No.

As an example here about receipts, the committee reports say:

Moreover, expenditures merely incidental to entertainment, travel, etc., such as taxicab fares, tips and similar payments will be deductible if they are substantiated by such a diary, account book, or similar record.

That is all that would be required today.

Senator SMATHERS. Are you now saying that even if it went above $25, they would not have to have a receipt?

Mr. CAPLIN. No. I will say this: That the regulations say that for an individual expenditure of $25 or more, then a receipt is normally required. But there are two other provisions in the regulations:

(1) That if a man does not have the receipt, he can still get the deduction through other evidence, such as evidence of someone who was with him, who said this was expended.

(2) There also is a provision in the regulations that, if there are circumstances where it would be difficult to get a receipt, that that, too, would excuse any receipt requirement.

Senator SMATHERS. Has any publicity been given to that particular regulation?

Mr. CAPLIN. They were actually stated. They are right in the regulations. It all depends on how carefully they are read. I think part of the difficulty, Senator, if you will permit me, is that there is a misunderstanding of these regulations. I have asked lawyers where could we improve them: what could be done and still be responsive to the congressional direction here. I have not got anybody to suggest substantive corrections.

Senator SMATHERS. I am curious to just get a direct answer as to whether or not you think the statute permitted you to put a limitation of $10, as you originally did, or $25, or for that matter, any dollar limitation, on this matter requiring receipts?

Mr. CAPLIN. The statute specifically refers to the elimination of requirements for substantiation up to a given amount. There is a reference to a figure, reference to a line to be drawn, which indicates that a figure is contemplated.

Senator SMATHERS. What is that? I am curious to see what that is.

Mr. LAMONT. It is the last sentence of 274(d).

Mr. CAPLIN. May we have a copy of the statute, please? Thank you very much. The statute starts off saying:

No deduction shall be allowed

this is section 274(d)—under section 162 or 212, under (1), and then it says:

(2) For any item with respect to any activity which is of a type generally considered to constitute entertainment, amusement or recreation,

and I will skip.

(3) For any expense for gifts unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement, (*a*) the amount of such expense or other item; (*b*) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or the data and description of the gift; (*c*) the business purpose of the expense or other items; and (*d*) the business relationship to the taxpayer of persons entertained, using the facility or receiving the gift.

Here is the crucial sentence:

The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

Senator SMATHERS. You see what you have done, Mr. Caplin. Where that sentence would seem to suggest that you require less substantiation, you have interpreted it making it more stringent. You have set an amount. You have said that there is a requirement to have receipts for everything above a certain amount, that is not stated in the statute.

The statute said you may waive even some of the requirements that are called for in the statute.

Mr. CAPLIN. Senator, I referred to, just a while ago, the fact that there are two other provisions in the regulations which would eliminate the need for the receipt.

Don, could you pick those out in the regulations?

Mr. LAMONT. Yes; this is the question which puts it into the layman's language.

Mr. CAPLIN. The question and answer booklet which you have before you, Senator, on page 19, I think you might find this interesting, question 21:

Is it possible to obtain a tax deduction for an entertainment expenditure of over $25 if a receipt is not obtained.

This is on page 19, sir. The answer is:

A receipt ordinarily is the best evidence to prove the amount of expenditure. However, it may be possible to obtain a deduction for an expenditure of $25 or more, even without a supporting receipt. The regulations provide that a taxpayer who does not have adequate records to substantiate a deduction may establish his right to a deduction by other evidence, such as a statement in writing of witnesses containing sufficient information. In addition, the regulations provide special rules for cases where, by reason of the inherent nature of the situation in which an expenditure is made, a taxpayer is unable to obtain a receipt or where a taxpayer cannot produce a receipt for reasons beyond his control, such as a loss of the receipt by fire, flood or other casualty.

Again, I think a lot of the criticism is because of misunderstanding. Now, the representative from the restaurant association met with me. He pulled out of his pocket a little, tiny card that he had, and he said,

"I had lunch with somebody this afternoon. This is all I would have to say, and I would be in full compliance with the rules."

And he just wrote down four or five words.

Senator SMATHERS. Is that what he said or what you said?

Mr. CAPLIN. He said and I agreed with him.

You see, it is not required on the recordkeeping that it all be in the diary, if correspondence, the normal records of the company would indicate business relationships.

Then there would be no need for repeating this in the diary book.

Senator SMATHERS. That is a point that I think would be helpful, if we can make that very clear.

What you are saying, for the record, as I understand it, is that, in point of fact, you do not have to have receipts for everything. You do have to have some kind of proof, some kind of substantiation, but you do not, even though you have a $25 limitation, nevertheless, there are regulations which you will let a taxpayer prove what he claims would be a business expense without actually having to have a receipt?

Mr. CAPLIN. That is correct, sir.

Senator SMATHERS. All right, that is very helpful. I do not believe that many people understand it.

Mr. CAPLIN. I have tried to make that clear.

Senator SMATHERS. Not at the present moment.

Mr. CAPLIN. Every time I have had the opportunity and the time, I have made speeches to point that out.

Senator SMATHERS. Let me just go to the next thing about this degree of proof which you have got a regulation on. As I understand it, your regulations on travel and actually entertainment have not yet been published, is that right?

Mr. CAPLIN. That is right, the so-called substantive regulations on defining what is directly related to the active conduct of a trade or business and what is meant by a bona fide and substantial business meeting in statutory terms.

Senator SMATHERS. So the only regulations that we are talking about now are just the regulations which pertain to the substantiation. Those are the only ones that you have thus far issued?

Mr. CAPLIN. That is right, sir.

Senator SMATHERS. Did you read the article in the Wall Street Journal of this morning?

Mr. CAPLIN. Yes, I saw that this morning.

Senator SMATHERS. Do you think there is any justification for the article which throughout implies that you are going to write regulations that are much more strict, even, than businessmen thought they would be?

Mr. CAPLIN. I would say this:

That we would have no authority and we have no intention of making the regulations stricter than what Congress intended. Now, what I think the Wall Street Journal had reference to was to what the state of the law is today, the fact that many people do not understand the state of the law.

They referred to a particular decision, a recent decision of the seventh circuit, on the deductibility of wives, and they indicated that a lot of people do not understand the whole issue of when wives are deductible.

QUESTIONS SUBMITTED BY SENATOR SMATHERS

Question No. 39.—What would the enforcement policy of the Internal Revenue Service be under these separate but similar hypothetical factual situations:

(1) A is the president of X Corp. and confers in his office on an important matter with two of his vice presidents, and his sales manager. At lunchtime the business discussion is not concluded, and A decides to adjourn the conference to a nearby restaurant and continue the discussion during lunch. A pays the lunch tab for all four persons and receives reimbursement for the entire amount from the corporation.

(2) B is the president of Y Corp. The facts are the same as in (1) above, except that Y Corp. maintains an executive dining room, to which the participants retire for lunch to continue the discussion. The cost of the lunch is borne by the corporation under the cost of maintaining the dining room.

What is the deductible status of the cost of the meals in each of the examples above; if any difference, what is it and why?

Answer.—From the facts given, it appears that the corporation's deduction in the first situation would not be disallowed under the new rules since the meal meets the requirements of the "business meal" exception contained in section 274(e)(1). Also, in the second situation, assuming that the executive dining room is on the business premises of the corporation, and the expense is an ordinary and necessary business expense under prior law, the cost of the lunches would meet the requirements of the "food and beverages for employees" exception contained in section 274(e)(2). Accordingly the expenses would not be disallowed under section 274(a).

Question No. 40.—What would the enforcement policy of the Internal Revenue Service be under this hypothetical factual situation:

A is a manufacturer of "Boy-Girl" bicycles. In order to impress the youngsters with the attributes of "Boy-Girl" bicycles with the hope that the youngsters will exercise their parental influence to the end that the parents, when buying bicycles, will buy "Boy-Girl" bicycles, A gives an outdoor party for 200 youngsters of the bicycle age. At the party, food and refreshments (nonalcoholic) are served the youngsters, free rides on Boy-Girl bicycles are given, and other forms of entertainment furnished the youngsters. Is the cost of the entertainment a deductible business expense, and if so, is it deductible as an entertainment expense or as an advertising expense?

Answer.—The Service proposes to treat entertainment occurring in a "clear business setting" as directly related to the active conduct of business. Entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between the taxpayer and the recipients of the entertainment, as in the case given, generally will qualify for deduction under this rule.

Question No. 41.—Mr. Commissioner, in your original proposed regulation did you not call for a record of the description of entertainment?

In your final regulation you call for a record of the "designation of the type of entertainment." Is that correct?

Does the statute call for either a "description" or a "designation"? (Note: Answer must be "No.")

Let me recite the requirements of the statute. The statute says the taxpayer must make records of: "(A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift."

The statute asks for a description of gifts, but it does not ask for a description of entertainment. If we had wanted a description of both, don't you think we would have asked for it?

Do you feel you have complied with our intent by requiring a description? I think you have exceeded it.

Answer.—The statute does not specifically refer to a "description" or "designation" of entertainment.

However, the accompanying committee reports, and the Senate floor debates give a fairly clear indication that the purpose of the recordkeeping rules of section 274(d) is to require a taxpayer to * * * "clearly establish his right to the deduction. * * * By these requirements the taxpayer must reveal to the tax collector all the information he needs to make a determination with respect to

any claimed entertainment expense." (Quoted from statement of summation of Senator Smathers, in the Senate floor debates on sec. 274(d), 108 Congressional Record No. 155, Aug. 20, 1962, p. 17001.)

Ordinarily, the specific statutory requirement that the "place of entertainment" be recorded should by itself be sufficient to give the type of information necessary to properly apply the substantive provisions of the new "T. & E." law. However, in those situations where the "place of entertainment" does not indicate the type of entertainment, a revenue agent (or an employer in the case of reimbursed expenses of employees) might not be able to ascertain whether the expenditure is deductible unless the particular type of entertainment is recorded. For example, if a taxpayer merely records that he spent a certain amount for entertaining a particular customer at "place X", it could be that the place is a restaurant or a hotel dining room conducive to a business deduction discussion to which the business meal exception applies. On the other hand if "place X" is a night club, where there are substantial distractions, such as floor show, the more restrictive requirements of the new substantive law applies before the expense is deductible. In this type of case, if the expense is incurred by an employee under a reimbursement arrangement, setting forth the type of entertainment would be required by a prudent employer so that the employer could justify the deduction. In the case of a self-employed taxpayer, setting forth the type of entertainment not only avoids problems of inaccurate recall, but will enable a revenue agent to audit the expense account without burdensome questioning of the taxpayer. Since the type of entertainment may be the crucial factor in determining deductibility, it would be unfair and misleading to taxpayers not to instruct them to keep a record of this factor.

Question No. 42.—Mr. Commissioner, In the technical part of the committee report, which you know is generally written by representatives of your Department, there is an example illustrating the application of the rule requiring allocation of travel expenses where travel exceeds one week and the personal portion of the trip represents more than 25 percent of the total time away from home. (S. Rept. 1881, 87th Cong., p. 172.) This example makes it clear that travel time is to be treated as business time.

Doesn't this sort of rule make the whole allocation formula sort of ridiculous? For instance, in the example cited the taxpayer attributed fourteen-eighteenths of his trip to personal purposes. The 2 days of business and the 2 days of travel gave him four-eighteenths for business purposes. Now if that same individual instead of taking a fast jet to London had taken a slow boat which would have involved 5 days of travel over and 5 days of travel back, and if he had spent the same 2 days on business in London and the same 2 weeks on vacation on the Continent, he would have been permitted to allocate twelve-twenty-sixths of his expense to business and fourteen-twentysixths to personal purposes. This would give him a deduction of nearly 50 percent. If he goes by jet, his deduction is 22 percent of his cost.

Are these computations about accurate?

Don't you agree that these consequences are irrational?

Answer.—These computations appear to be correct unless the taxpayer is able to establish that a different method of allocation more clearly reflects the time which is attributable to business. We agree that counting "in transit" time as business time weighs the scale in favor of the taxpayer who chooses to travel by the slow means of transportation. On balance, however, it seems that a taxpayer should be permitted to choose a reasonable mode of transportation as long as he travels for business purposes by a reasonably direct route to his business destination. We do not believe that this particular factor will be a significant one in selecting the mode of transportation since the Service proposes that the entire cost of travel to and from the business destination will be deductible unless the taxpayer has substantial control over arranging his business trip and a major consideration in determining to make the trip is to obtain a vacation or holiday. Furthermore, even where the allocation rules apply, the taxpayer may be able to establish that a method of allocation, other than one based solely on a comparison of business days and personal days, more clearly reflects the portion of time which is attributable to business.

Question No. 43.—Subsection 274(*d*), upon which the new substantiation regulations are based, requires that certain elements of an expenditure be established. Among these statutory elements are business purpose of the expense and the business relationship to the taxpayer of the persons entertained.

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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 380

WILLIAM F. SANFORD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. 5a–19a) are reported at 50 T.C. 823. The opinion of the court of appeals (Pet. 1a–3a) is not yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered June 24, 1969. The petition for a writ of certiorari was filed on July 24, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below correctly held that Treasury Regulations requiring a taxpayer to main-

tain documentary evidence in addition to an account book, diary, statement of expense or similar record, to support an entertainment expenditure of $25 or more, are valid and consistent with the requirement of Section 274(d) of the Internal Revenue Code of 1954 that a taxpayer substantiate each element of an entertainment expenditure by adequate records or by sufficient evidence corroborating his own statement.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of Sections 274 and 7805 of the Internal Revenue Code of 1954 and Section 1.274–5 of Treasury Regulations on Income Tax are set forth in the Appendix, *infra*, pp. 9–17.

STATEMENT

The petitioner, William F. Sanford, during the year involved in this case, 1963, was employed as an outside salesman of television advertising time for RKO General Broadcasting, Inc. (hereinafter referred to as RKO). (Pet. 5a.) Most of petitioner's sales were made through the presentation of recommendations to buy television advertising time, and these "presentations" were often made at luncheons or dinners, either at restaurants or at his home. (Pet. 5a.) Petitioner was reimbursed by RKO for some of these expenditures, generally on the average of $50 to $60 per week, but it was understood that, for the most part, he would have to bear all entertainment expenses above this weekly amount. (Pet. 5a.) Petitioner worked primarily on a commission basis, and his rate of compensation took into account the fact that he

occasionally incurred expenses in obtaining and keeping accounts for which he was not reimbursed. (Pet. 5a–6a.) On his federal income tax return for the year 1963, petitioner listed "outside salesman expenses" totalling $13,950.35, less reimbursement from his employer, RKO, of $4,431.93, and deducted the difference of $9,518.42 as nonreimbursed employee business expenses.

Among the "outside salesman expenses" listed by petitioner was an item for "Entertainment, from my record" in the amount of $8,853.35. Petitioner had been reimbursed by RKO for a portion of these expenses in the amount of $3,186.18, so that his claimed nonreimbursed entertainment expenses came to $5,667.17. (Pet. 6a.)

Of the $5,667.17, the Commissioner allowed $682.86 representing the total of petitioner's alleged nonreimbursed entertainment expenses in individual amounts of less than $25. (Pet. 6a.) He disallowed the balance, $4,984.31, consisting of alleged nonreimbursed entertainment expenses in individual amounts of $25 or more. (Pet. 6a.) It is this disallowance that petitioner disputes.[1]

Petitioner filed a detailed expense account with his employer as to those entertainment expenses for which he sought and obtained reimbursement from his employer. (Pet. 6a.) A number of these expenses were supported by receipts or other documentary evidence, and most ranged from about $10 to $25 each. In addi-

[1] Petitioner did not dispute the disallowance of an additional $815.74 of his claimed employee business expense deduction. (Pet. 6a.)

tion petitioner maintained a desk calendar or "diary" on which he recorded those entertainment expenditures for which he did not seek reimbursement. Most of these expenditures represented the alleged cost of dinners, and most involved amounts in excess of $25. (Pet. 6a–7a.) The entries on the calendar identified the names of the persons entertained, the amount allegedly spent, and, by abbreviation or code, the restaurant, the advertising agency, and the alleged reason for the entertainment. The particular client or account involved in the alleged business discussion was not identified, and in respect of none of the items recorded did petitioner obtain or retain any supporting receipt or other documentary evidence. (Pet. 7a.)

The Tax Court sustained the Commissioner's determination disallowing the alleged entertainment expenditures of $25 or more, and held that Section 1.274–5(c)(2)(iii) of Treasury Regulations on Income Tax requiring documentary evidence to support an expenditure of $25 or more is valid. (Pet. 4a–19a.) The Court of Appeals for the Second Circuit affirmed *per curiam*. (Pet. 1a–3a.)

ARGUMENT

The decision below is correct and there is no conflict or other ground warranting further review.

1. Section 162 of the Internal Revenue Code of 1954 provides for the allowance of a deduction for all ordinary and necessary expenses paid or incurred by a taxpayer during the taxable year in carrying on a trade or business. As a part of the Revenue Act of 1962, P.L. 87–834, 76 Stat. 960, Congress enacted Sec-

tion 274 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 9, in an attempt to curb the widespread abuse in the use by taxpayers of expense accounts, and to require taxpayers to produce more than their unsupported self-serving written or oral testimony to substantiate the deduction of entertainment expenditures as ordinary and necessary business expenses under Section 162 of the Code. H. Rep. No. 1447, 87th Cong., 2d Sess., p. 19 (1962–3 Cum. Bull. 405, 423); S. Rep. No. 1881, 87th Cong., 2d Sess., pp. 24–25 (1962–3 Cum. Bull. 707, 730–731).

Section 274(a)(1)(A) of the Code provides for the disallowance of the deduction of entertainment, amusement, or recreation expenses as ordinary and necessary business expenses unless the taxpayer can establish that such expenses are "directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion * * * that such item was associated with, the active conduct of the taxpayer's trade or business * * *." Section 274(d) of the Code, which we are concerned with here, provides that no deduction shall be allowed with respect to an entertainment activity "unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement" the amount, time and place, and business purpose of the entertainment expense and the business relationship to the taxpayer of the persons entertained. Pursuant to the specific authority given to the Secretary or his delegate in Section 274(h) of the Code, and the Secretary's general regulatory authority contained in Section 7805 of the Code, Appendix *infra*, p. 10, Regu-

lations were promulgated under Section 274 to carry out the Congressional purpose of that section.

Because the term "adequate records" in Section 274(d) is not self-defining, the Commissioner has interpreted it to require the maintenance by the taxpayer of a diary, account book, or similar record, plus, in the case of entertainment expenditures of $25 or more (with exceptions not relevant here), documentary evidence in the form of receipts, paid bills or similar evidence. Treasury Regulations on Income Tax (1954 Code), Sections 1.274–5(c)(2)(i) and 1.274–5(c)(2)(iii), Appendix, *infra*, p. 12. In this interpretation the Commissioner has sought to carry out the Congressional purpose in enacting Section 274 and has achieved a sensible balance by relieving taxpayers of the burden of having to obtain and retain documentary evidence to support entertainment expenditures of less than $25.

Petitioner contends that a diary alone constitutes "adequate records" within the meaning of Section 274(d), and that the Commissioner exceeded his authority in defining "adequate records" as consisting of both a diary and documentary evidence in the case of entertainment expenditures of $25 or more. (Pet. 9.) Petitioner's contention is without merit.

The pertinent Regulations are entirely reasonable. Neither the legislative history nor the purpose for which Section 274(d) was enacted suggests that the authority given the Secretary in Section 274(h) to promulgate Regulations has been abused or exceeded.

Regulations, especially when expressly authorized by the applicable statute, carry a strong presumption of validity. *Farrel-Birmingham Co.* v. *United States,* 121 F. Supp. 636 (Ct. Cl.). This Court has declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the statute under which they are promulgated. *Commissioner* v. *South Texas Co.,* 333 U.S. 496. The court below thus was correct in its holding that (Pet. 3a):

> Here the disputed Regulation is not inconsistent with the statute, for the phrase "adequate records" is clearly open to interpretation, and the Regulation interprets the phrase so as to carry out the stated congressional purpose of insuring "that no deduction is allowed solely on the basis of his own [the taxpayer's] unsupported self-serving testimony." * * *

Contrary to petitioner's assertion (Pet. 9–11), the Regulations do not require a taxpayer to substantiate entertainment expenses both by "adequate records" and by "sufficient evidence corroborating his own statement" in contravention of the statute which permits substantiation by either of the means specified. If a taxpayer does not have "adequate records" as defined in the Regulations, including documentary evidence where required, he may, in accordance with Section 1.274–5(c)(3), substantiate his expenses without such evidence by "other sufficient evidence"—*e.g.,* the statement or oral testimony of the person entertained. Petitioner's argument rests on the erroneous assumptions that a diary alone constitutes "adequate records", and that documentary evidence is "other sufficient evidence" for purposes of the statute.

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2. It is clear that petitioner failed to substantiate the entertainment expenses here in question by either of the methods prescribed in Section 274(d), and the courts below correctly so found. Petitioner produced only one part of the "adequate records" required by the statute, that of the diary, and even this was found to be inadequate. (Pet. 3a, 10a.) He failed to produce any documentary evidence to support the self-serving statements in his diary. Moreover, he made no attempt to corroborate his diary entries by "other sufficient evidence" as permitted by Section 1.274–5(c)(3) of the Regulations. To allow a deduction in these circumstances would plainly be inconsistent with Section 274(d) and with the Congressional purpose in enacting that provision.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1969.

APPENDIX

Internal Revenue Code of 1954:

SEC. 274 [as added by Sec. 4(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(a) *Entertainment, Amusement, or Recreation.*—

(1) *In general.*—No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) *Activity.*—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

* * * * *

(d) *Substantiation Required.*—No deduction shall be allowed—

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, or

(3) for any expense for gifts,

unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating

his own statement (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of persons entertained, using the facility, or receiving the gift. The Secretary or his delegate may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations.

* * * * *

(h) *Regulatory Authority.*—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, including regulations prescribing whether subsection (a) or subsection (b) applies in cases where both such subsections would otherwise apply.

[26 U.S.C. 274.]

SEC. 7805. RULES AND REGULATIONS.

(a) *Authorization.*—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

* * * * *

[26 U.S.C. 7805.]

Treasury Regulations on Income Tax (1954 Code):

§ 1.274–5 *Substantiation requirements.*

(a) *In general.* No deduction shall be allowed for any expenditure with respect to—

* * * * *

(2) Any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity, including the items specified in section 274(e), or

* * * * *

unless the taxpayer substantiates such expenditure as provided in paragraph (c) of this section. This limitation supersedes with respect to any such expenditure the doctrine of Cohan v. Commissioner (C.C.A. 2d 1930) 39 F.2d 540. The decision held that, where the evidence indicated a taxpayer incurred deductible travel or entertainment expense but the exact amount could not be determined, the court should make a close approximation and not disallow the deduction entirely. Section 274(d) contemplates that no deduction shall be allowed a taxpayer for such expenditures on the basis of such approximations or unsupported testimony of the taxpayer. For purposes of this section, the term "entertainment" means entertainment, amusement, or recreation, and use of a facility therefor; and the term "expenditure" includes expenses and items (including items such as losses and depreciation).

* * * * *

(c) *Rules for substantiation*—(1) *In general.* A taxpayer must substantiate each element of an expenditure (described in paragraph (b) of this section) by adequate records or by sufficient evidence corroborating his own statement except as otherwise provided in this section. Section 274(d) contemplates that a taxpayer will maintain and produce such substantiation as will constitute clear proof of an expenditure for travel, entertainment, or gifts referred to in section 274. A record of the elements of an expenditure made at or near the time of the expenditure, supported by sufficient docu-

mentary evidence, has a high degree of credibility not present with respect to a statement prepared subsequent thereto when generally there is a lack of accurate recall. Thus, the corroborative evidence required to support a statement not made at or near the time of the expenditure must have a high degree of probative value to elevate such statement and evidence to the level of credibility reflected by a record made at or near the time of the expenditure supported by sufficient documentary evidence. The substantiation requirements of section 274(d) are designed to encourage taxpayers to maintain the records, together with documentary evidence, as provided in subparagraph (2) of this paragraph. To obtain a deduction for an expenditure for travel, entertainment or gifts, a taxpayer must substantiate, in accordance with the provisions of this paragraph, each element of such an expenditure.

(2) *Substantiation by adequate records*—(i) *In general.* To meet the "adequate records" requirements of section 274(d), a taxpayer shall maintain an account book, diary, statement of expense or similar record (as provided in subdivision (ii) of this subparagraph) and documentary evidence (as provided in subdivision (iii) of this subparagraph) which, in combination, are sufficient to establish each element of an expenditure specified in paragraph (b) of this section. It is not necessary to record information in an account book, diary, statement of expense or similar record which duplicates information reflected on a receipt so long as such account book and receipt complement each other in an orderly manner.

(ii) *Account book, diary, etc.* An account book, diary, statement of expense or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure is made at or near the time of the expenditure.

(a) *Made at or near the time of the expenditure.* For purposes of this section, the phrase "made at or near the time of the expenditure" means the elements of an expenditure are recorded at a time when, in relation to the making of an expenditure, the taxpayer has full present knowledge of each element of the expenditure, such as the amount, time, place and business purpose of the expenditure and business relationship to the taxpayer of any person entertained. An expense account statement which is a transcription of an account book, diary, or similar record prepared or maintained in accordance with the provisions of this subdivision shall be considered a record prepared or maintained in the manner prescribed in the preceding sentence if such expense account statement is submitted by an employee to his employer or by an independent contractor to his client or customer in the regular course of good business practice.

(b) *Substantiation of business purpose.* In order to constitute an adequate record of business purpose within the meaning of section 274 (d) and this subparagraph, a written statement of business purpose generally is required. However, the degree of substantiation necessary to establish business purpose will vary depending upon the facts and circumstances of each case. Where the business purpose of an expenditure is evident from the surrounding facts and circumstances, a written explanation of such business purpose will not be required. For example, in the case of a salesman calling on customers on an established sales route, a written explanation of the business purpose of such travel ordinarily will not be required. Similarly, in the case of a business meal described in section 274(e)(1), if the business purpose of such meal is evident from the business relationship to the taxpayer of the persons entertained and other surrounding circumstances, a written explana-

tion of such business purpose will not be required.

(c) *Confidential information.* If any information relating to the elements of an expenditure, such as place, business purpose or business relationship, is of a confidential nature, such information need not be set forth in the account book, diary, statement of expense or similar record, provided such information is recorded at or near the time of the expenditure and is elsewhere available to the district director to substantiate such element of the expenditure.

(iii) *Documentary evidence.* Documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure shall be required for—

(a) Any expenditure for lodging while traveling away from home, and

(b) Any other expenditure of $25 or more, except, for transportation charges, documentary evidence will not be required if not readily available.

provided, however, that the Commissioner, in his discretion, may prescribe rules waiving such requirements in circumstances where he determines it is impracticable for such documentary evidence to be required. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, and, if a charge is made for an item other than meals and beverages, an indication that such is

the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check, together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose.

(iv) *Retention of documentary evidence.* The Commissioner may, in his discretion, prescribe rules under which an employer may dispose of documentary evidence submitted to him by employees who are required to, and do, make an adequate accounting to the employer (within the meaning of paragraph (e)(4) of this section) if the employer maintains adequate accounting procedures with respect to such employees (within the meaning of paragraph (e)(5) of this section).

(v) *Substantial compliance.* If a taxpayer has not fully substantiated a particular element of an expenditure, but the taxpayer establishes to the satisfaction of the district director that he has substantially complied with the "adequate records" requirements of this subparagraph with respect to the expenditure, the taxpayer may be permitted to establish such element by evidence which the district director shall deem adequate.

(3) *Substantiation by other sufficient evidence.* If a taxpayer fails to establish to the satisfaction of the district director that he has substantially complied with the "adequate records" requirements of subparagraph (2) of this paragraph with respect to an element of an expenditure, then, except as otherwise provided in this paragraph, the taxpayer must establish such element—

(i) By his own statement in writing containing specific information in detail as to such element; and

(ii) By other corroborative evidence sufficient to establish such element.

If such element is the description of a gift, or the cost, time, place, or date of an expenditure, the corroborative evidence shall be direct evidence, such as a statement in writing or the oral testimony of persons entertained or other witness setting forth detailed information about such element, or the documentary evidence described in subparagraph (2) of this paragraph. If such element is either the business relationship to the taxpayer of persons entertained or the business purpose of an expenditure, the corroborative evidence may be circumstantial evidence.

(4) *Substantiation in exceptional circumstances.* If a taxpayer establishes that, by reason of the inherent nature of the situation in which an expenditure was made—

(i) He was unable to obtain evidence with respect to an element of the expenditure which conforms fully to the "adequate records" requirements of subparagraph (2) of this paragraph,

(ii) He is unable to obtain evidence with respect to such element which conforms fully to the "other sufficient evidence" requirements of subparagraph (3) of this paragraph, and

(iii) He has presented other evidence, with respect to such element, which possesses the highest degree of probative value possible under the circumstances, such other evidence shall be considered to satisfy the substantiation requirements of section 274(d) and this paragraph.

(5) *Loss of records due to circumstances beyond control of taxpayer.* Where the taxpayer establishes that the failure to produce adequate records is due to the loss of such records through circumstances beyond the taxpayer's control, such as destruction by fire,

flood, earthquake, or other casualty, the taxpayer shall have a right to substantiate a deduction by reasonable reconstruction of his expenditures.

* * *

[26 C.F.R. 1.274–5.]

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IN THE

Supreme Court of the United States

October Term, 1969

No. 380

WILLIAM F. SANFORD,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

Reasons for this Reply Brief

This Reply Brief is addressed to the following arguments first raised in the brief in opposition:

1. An adequate record is an unsupported self-serving written testimony if it is not coupled with documentary evidence. (First paragraph of Bro* 5).

2. To require documentary evidence over and above an adequate record is only an interpretation of the word "adequate". (Second paragraph of Bro 6).

3. Contrary to petitioner's assertion (Pet. 9-11), the Regulations do not require a taxpayer to substantiate entertainment expenses both by "adequate records" and by "sufficient evidence corroborating his own statement" in

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*"Bro" denotes the brief for the respondent in opposition.

contravention of the statute which permits substantiation by either adequate records or no records but a statement corroborated by sufficient evidence. (Second paragraph of Bro 7).

4. Does interpretation of a statute include to add to the statute something what it does not contain? (Second paragraph of Bro 6).

5. The Commissioner does not exceed his authority if his Regulations are entirely reasonable. (Last paragraph of Bro 6).

6. Petitioner's diary was found to be inadequate. (Lines 6-7 of Bro 8).

ARGUMENT

1. As the Law mandatorily prescribes that the taxpayer has to substantiate his business entertaining expenses "by adequate records" (Section 274(d)), the Government cannot degrade it by labeling petitioner's proof according to the Statute as "unsupported self-serving written * * * testimony" (Bro 5). This argument of the respondent is contrary to Law, and therefore invalid. At the same time it shows the Government's weakness in having to resort to such distortion.

2. The word "adequate" refers to the record, consequently only the quality of the record itself could be meant by Congress. Any further piece of evidence—as e.g. any documents—is extraneous. If all of the elements spelled out by the statute are recorded by the petitioner then petitioner's record is "adequate" according to statutory definition.

Petitioner does not have to rely on this simple confusion of the governmental authorities dealing with his complaint. That confusion is rooted much deeper:

3. Section 274(d) does contain a mandatory rule about documentary evidence, called "sufficient evidence corroborating his own statement."

This, however, relates clearly to the substantiation by a taxpayer's "own statement", which, in turn, is dissociated through the use of the disjunctive "or" from a substantiation "by adequate records". It is very impressive to observe the laborious endeavor to connect what is disconnected by the Law, to require documents for corroboration not only of a taxpayer's "own statement" but also a taxpayer's "adequate record", which endeavor is clearly barred by the Law, barred by Congress and barred by logic.

To achieve this, the distortion of the word "adequate" will not suffice until there is the Law, the Congress—and the logic.

Further contradictions arising of this laborious distortion:

4. There are several approaches and efforts to strain and extend the realm of interpretation by Regulations, Rulings, and the pertinent authority of those who are entrusted to make them. But there never was and never can be such a monstrosity, as to suppose that any interpretation could add to the statute something that it does not contain.

This is what is needed to uphold the position of respondent, second paragraph of Bro 6. A position which is built on such monstrosity is, itself, equally monstrous. Moreover

5. in the last paragraph of page 6 of its brief, the Government underpins its position by stating:

> "The pertinent Regulations are entirely reasonable."

Reasonableness in itself will never be enough to uphold the validity of a Regulation. On the contrary:

> "* * * it is only the power to carry into effect the will of Congress as expressed by the statute. *Manhattan Company v. Commissioner*, 297 U.S. 129."

and negatively:

> "A regulation may not alter or amend the revenue law, nor extend a statute or modify its provisions,"

as in the present matter. *Campbell* v. *Galeno Chemical Co.*, 281 U.S. 599.

That the Government finds it to be sufficient if the Regulation is "entirely reasonable", suggests that there was no stronger argument available and especially that both the aforementioned positive and negative requirements are missing.

6. All of the entertainment expenses in individual amounts of less than $25 were approved by respondent and deducted, and were not put in issue. (Pet. 6a and Bro third paragraph p. 3).

This admitted fact of adequacy and appropriateness of petitioner's record as

> "Any fact bearing upon the issue involved, admitted by counsel, may be the ground of the Court's procedure equally as if established by the clearest proof." *Oscanyan* v. *Arms Co.*, 103 U.S. 261, 263; 26 L.Ed 539 (1880).
>
> "Facts judicially admitted [Pet. 6a. and Bro third paragraph p. 3] are facts established not only beyond the need of evidence to prove them, but beyond the power of evidence to controvert them." *Hill* v. *Federal Trade Commission* (5CA), 124 F. 2d 104, 106 (1941).

CONCLUSION

For all the foregoing reasons, a writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

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